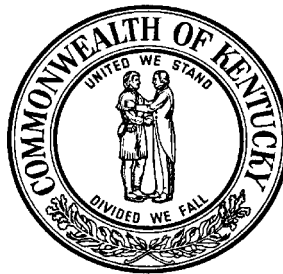


**REPORT OF THE AUDIT OF THE
KENTUCKY TRANSPORTATION CABINET
SCHEDULE OF REVENUES AND EXPENDITURES -
CASH BASIS**

**For The Fiscal Year Ended
June 30, 2002**



EDWARD B. HATCHETT, JR.
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EDWARD B. HATCHETT, JR.
AUDITOR OF PUBLIC ACCOUNTS

To the People of Kentucky
Honorable Paul E. Patton, Governor
James C. Codell, III, Secretary
Kentucky Transportation Cabinet

The enclosed report, prepared by Potter & Company, LLP, Certified Public Accountants, presents the Transportation Cabinet's schedule of revenues and expenditures - cash basis for the year ended June 30, 2002. The schedule is the responsibility of the Cabinet's management.

We engaged Potter & Company, LLP, to perform the audit of the schedule of revenues and expenditures. We worked closely with the firm during our report review process.

Respectfully submitted,

Edward B. Hatchett, Jr.
Auditor of Public Accounts

Enclosure



**TRANSPORTATION CABINET OF THE
COMMONWEALTH OF KENTUCKY
FRANKFORT, KENTUCKY**

**INDEPENDENT AUDITOR'S REPORT
ON SCHEDULE OF REVENUES AND
EXPENDITURES – CASH BASIS**

June 30, 2002

**TRANSPORTATION CABINET OF
THE COMMONWEALTH OF KENTUCKY
FRANKFORT, KENTUCKY**

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INDEPENDENT AUDITOR'S REPORT

Mr. James C. Codell, III, Secretary
Transportation Cabinet of the
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr., Auditor of Public Accounts
Commonwealth of Kentucky
Frankfort, Kentucky

We have audited the accompanying schedule of revenues and expenditures – cash basis of the Transportation Cabinet of the Commonwealth of Kentucky as of and for the year ended June 30, 2002. The schedule is the responsibility of the Cabinet's management. Our responsibility is to express an opinion on the schedule based on our audit.

We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States. Those standards require that we plan and perform the audit to obtain reasonable assurance about whether the schedule of revenues and expenditures - cash basis is free of material misstatement. An audit includes examining, on a test basis, evidence supporting the amounts and disclosures in the schedule of revenues and expenditures – cash basis. An audit also includes assessing the accounting principles used and significant estimates made by the Cabinet's management, as well as evaluating the overall schedule presentation. We believe that our audit provides a reasonable basis for our opinion.

As discussed in Notes 2 and 3, this schedule has been prepared in the format prescribed by the Commonwealth of Kentucky, Auditor of Public Accounts using the cash receipts and disbursement basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles, and is not intended to be a presentation in conformity with accounting principles generally accepted in the United States of America.

In our opinion, the schedule referred to in the first paragraph presents fairly, in all material respects, the revenues and expenditures of the Transportation Cabinet of the Commonwealth of Kentucky for the year ended June 30, 2002, on the basis of presentation and basis of accounting described in Notes 2 and 3.

In accordance with *Government Auditing Standards*, we have also issued our report dated October 25, 2002, on our consideration of the Transportation Cabinet of the Commonwealth of Kentucky's internal control over financial reporting and our tests of its compliance with certain provisions of laws, regulations, contracts and grants. That report is an integral part of an audit performed in accordance with *Government Auditing Standards* and should be read in conjunction with this report in considering the results of our audit.

Mr. James C. Codell, III, Secretary
Transportation Cabinet of the
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr., Auditor of Public Accounts
Commonwealth of Kentucky
Frankfort, Kentucky

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This report is intended solely for the information and use of the management of the Transportation Cabinet of the Commonwealth of Kentucky, the Auditor of Public Accounts of the Commonwealth of Kentucky, and the Finance and Administration Cabinet of the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties.

A handwritten signature in black ink that reads "Potter & Company, LLP". The script is cursive and fluid, with the letters "P" and "C" being particularly prominent.

POTTER & COMPANY, LLP
October 25, 2002

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
SCHEDULE OF REVENUES AND EXPENDITURES - CASH BASIS
June 30, 2002

ACCOUNT SUMMARY

GAAP Fund(s): General Fund, Federal Fund, Agency Revenue Fund

Agency Support Information on Material Accounts:

Provided by CAFR Team		
Fund	Account	Account Balance (1)
All Funds	Revenues	1,101,712,751
All Funds	Expenditures	1,917,258,311

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO SCHEDULE OF REVENUES AND EXPENDITURES – CASH BASIS
Year Ended June 30, 2002

NOTE 1 - REPORTING ENTITY

Kentucky Revised Statue Chapter 174 provides that the Transportation Cabinet (the Cabinet) has the responsibility for all the Commonwealth of Kentucky (State) owned transportation facilities and programs, including planning, financing, construction, operation and maintenance of various modes of transportation and carrying out related licensing and administrative functions. The Cabinet enters into various agreements with the Federal Highway Administration and the Turnpike Authority of Kentucky (the Authority), which is a related party, and provides part of the funding for highway construction projects.

The Cabinet is headed by the Secretary, whose staff is responsible for the following offices and departments: Office of General Counsel and Legislative Affairs, Office of Inspector General, Office of Minority Affairs, Office of Policy and Budget, Office of Public Affairs, Office of Quality, Office of Technology, Office of Transportation Delivery, Department of Administrative Services, Department of Fiscal Management, Department of Highways, Department of Human Resources Management, Department of Rural and Municipal Aid and Department of Vehicle Regulation. Within the Department of Highways there are five offices which are the responsibility of the State Highway Engineer, these are: Office of Project Development, Office of Construction and Operations, Office of Program Planning and Management, Office of Intermodal Planning, and the Highway District Offices.

The Special Revenue, Capital Projects, Internal Service and Agency Funds administrated by the Cabinet consolidate all fiscal resources dedicated to transportation, including license and privilege taxes, federal grants, the Authority's construction reimbursements, toll facility fares and General Fund appropriations. A significant portion of gasoline, special fuels and all usage taxes are collected by the Revenue Cabinet on behalf of the Cabinet.

The Cabinet's financial statements are included in the State's Comprehensive Annual Financial Report (CAFR).

NOTE 2 - BASIS OF PRESENTATION

The accompanying schedule of revenues and expenditures – cash basis was prepared for the purpose of submission to the Commonwealth of Kentucky, Auditor of Public Accounts (APA). The schedule was prepared in the format prescribed by the APA, and is not intended to be a presentation in conformity with accounting principles generally accepted in the United States of America.

The financial activities are recorded in individual funds classified by type as described below:

Special Revenue Fund - Transactions related to resources obtained, the uses of which are legally restricted to specific purposes, are accounted for in the Special Revenue Fund. The Special Revenue Fund includes resources used for operations and the Cabinet's share of leases on Toll, Economic Development and Resource Recovery Roads.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO SCHEDULE OF REVENUES AND EXPENDITURES – CASH BASIS
Year Ended June 30, 2002

NOTE 2 - BASIS OF PRESENTATION (CONTINUED)

Capital Project Funds - Transactions relating to the acquisition, construction, or renovation of the Cabinet's major capital facilities and for the acquisition of major equipment are accounted for in the Capital Projects Fund. Under Kentucky Revised Statutes, transactions for capital facilities and items of major equipment relating to the construction or maintenance of roads are not accounted for in the Capital Projects Fund and, accordingly, are recorded in the Special Revenue Fund.

Internal Service Funds - Internal Service Funds are used to account for the financing of goods or services provided by one department or agency to other departments or agencies of the government or to other governmental units, on a cost reimbursement basis. Internal Service Funds are composed of:

1. *Workers' Compensation Fund* - This fund is used to provide worker's compensation insurance to the employees of the Cabinet. Claims incurred by the Workers' Compensation Fund are serviced by a designated third-party administrator who processes and reports all claims to the Workers' Compensation Fund. Contributions are made from the Special Revenue Fund of the Cabinet based upon amounts budgeted for the Cabinet's fiscal year.
2. *Fleet Management Fund* - This fund is used to account for the rental of motor vehicles to other departments and related costs.

Agency Fund - Transactions related to assets held by the Cabinet for other governmental units, agencies or individuals are included in the Agency Fund.

NOTE 3 - BASIS OF ACCOUNTING

The accompanying schedule of revenues and expenditures has been prepared on the cash receipts and disbursements basis of accounting, which is a comprehensive basis of accounting other than generally accepted accounting principles. Under that basis, revenue is recognized when received rather than when earned and expenditures are recognized when paid rather than when the liability is incurred. Noncash transactions are not recognized in the schedule.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO SCHEDULE OF REVENUES AND EXPENDITURES – CASH BASIS
Year Ended June 30, 2002

NOTE 4 - CONTINGENCIES

As of June 30, 2002, the Cabinet has been named as a defendant in various legal actions seeking recovery of approximately \$43,000,000 in the aggregate. In the opinion of the Office of General Counsel of the Cabinet, the projected maximum liability (not considering any portions previously encumbered or reimbursable by another agency) with respect to these actions, determined in accordance with FASB No. 5, is approximately \$15,400,000.

During 2001 a verdict was reached in a class action suit against the Commonwealth of Kentucky allowing for a motor vehicle usage tax trade-in allowance for used vehicles purchased out of state but registered in Kentucky. Claimants must file an application to be eligible for a refund and at this time it is impossible to predict when refunds will be paid. In the opinion of the Office of General Counsel of the Cabinet, the amount of probable liability with respect to this action, determined in accordance with FASB No. 5, will be in the range of \$9,000,000 to \$12,000,000.

Federal grants are generally conditioned upon compliance with terms and conditions of the grant agreements and applicable federal regulations, including the expenditure of the resources for eligible purposes. Substantially all grants are subject to financial and compliance audits by the grantors. Any disallowances as a result of these audits become a liability of the Cabinet. During 2002 the Office of Inspector General (OIG) of the U.S. Department of Transportation conducted an investigation into cases involving fraud within the Disadvantaged Business Enterprise (DBE) program of the Cabinet. The Cabinet also conducted an internal review of the DBE program during 2002. Based on the findings of the internal review the Cabinet is in the process of implementing changes in the DBE program processes and procedures and is working with the Federal Highway Administration to expedite their approval. As a result of this re-organization within the Cabinet's DBE program the OIG has subsequently closed its investigation into this matter. Accordingly, management has determined in accordance with FASB No. 5 that there is no liability with respect to this matter at this time.

NOTE 5 - RELATED PARTY TRANSACTIONS

The Cabinet recognized construction expenditures of approximately \$50,520,000 during the year ended June 30, 2002, which were paid directly from the Economic Development Road (Revitalization Projects) Revenue Bonds proceeds.

The Cabinet operates the motor pool for the benefit of other agencies within the State. The motor pool is accounted for as the Fleet Management Fund, an Internal Service Fund. Departmental fees, sales and rentals include revenues of approximately \$28,090,000 for the year ended June 30, 2002, collected in connection with the operation of the motor pool.

The Governor's Office for Technology is responsible for providing services for State Government operations. The Cabinet has paid approximately \$8,307,000 to the Governor's Office for Technology for services provided during the year ended June 30, 2002.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
NOTES TO SCHEDULE OF REVENUES AND EXPENDITURES – CASH BASIS
Year Ended June 30, 2002

NOTE 5 - RELATED PARTY TRANSACTIONS (CONTINUED)

The Cabinet paid the Finance and Administration Cabinet approximately \$2,094,000 during the year ended June 30, 2002 for use of the State Office Building. Also, the Finance and Administration Cabinet's Office of Financial Management is authorized under Kentucky Revised Statue Chapter 42.410 to coordinate and manage the Cabinet's investment and idle the cash for the benefit of the Cabinet. The Cabinet has recognized approximately \$34,730,000 in interest payments from these investments during the fiscal year ended June 30, 2002. Additionally, the Cabinet received approximately \$8,323,000 in interest payments from the investment of the Economic Development Road (Revitalization Projects) Revenue Bonds proceeds during the year ended June 30, 2002.

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Certified Public Accountants • Business Advisors

Mr. James C. Codell, III, Secretary
Transportation Cabinet
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

We have audited the schedule of revenues and expenditures – cash basis of the Transportation Cabinet of the Commonwealth of Kentucky (the Cabinet) as of and for the year ended June 30, 2002, and have issued our report thereon dated October 25, 2002. We conducted our audit in accordance with auditing standards generally accepted in the United States of America and the standards applicable to financial audits contained in *Government Auditing Standards*, issued by the Comptroller General of the United States.

As part of obtaining reasonable assurance about whether the Cabinet's schedule of revenues and expenditures – cash basis is free of material misstatement, we performed tests of its compliance with certain provisions of laws, regulations, contracts and grants, noncompliance with which could have a direct and material effect on the determination of revenue and expenditure amounts. However, providing an opinion on compliance with those provisions was not an objective of our audit and, accordingly, we do not express such an opinion. The results of our tests disclosed no instances of noncompliance that are required to be reported under *Government Auditing Standards*.

In planning and performing our audit, we considered the Cabinet's internal control over financial reporting in order to determine our auditing procedures for the purpose of expressing our opinion on the schedule of revenues and expenditures – cash basis and not to provide assurance on the internal control over revenues and expenditures. Our consideration of the internal control over revenues and expenditures would not necessarily disclose all matters in the internal control over revenues and expenditures that might be material weaknesses. A material weakness is a condition in which the design or operation of one or more of the internal control components does not reduce to a relatively low level the risk that misstatements in amounts that would be material in relation to the schedule of revenues and expenditures – cash basis being audited may occur and not be detected within a timely period by employees in the normal course of performing their assigned functions. We noted no matters involving the internal control over revenues and expenditures and its operation that we consider to be material weaknesses.

Mr. James C. Codell, III, Secretary
Transportation Cabinet
Commonwealth of Kentucky and
Mr. Edward B. Hatchett, Jr.
Auditor of Public Accounts
Commonwealth of Kentucky

Page Two

This report is intended solely for the information and use of the Cabinet's management and the Auditor of Public Accounts of the Commonwealth of Kentucky and is not intended to be and should not be used by anyone other than these specified parties.

Potter & Company, LLP

POTTER & COMPANY, LLP
October 25, 2002

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
SCHEDULE OF FINDINGS
Year Ended June 30, 2002

Schedule of Auditor's Results

We have issued an unqualified opinion dated October 25, 2002, on the schedule of revenues and expenditures – cash basis of the Transportation Cabinet of the Commonwealth of Kentucky as of and for the year ended June 30, 2002.

Our audit disclosed no instances of noncompliance which are material to the Transportation Cabinet's schedule of revenues and expenditures – cash basis.

Findings Relating to the Financial Statements

Our audit disclosed no findings which are required to be reported in accordance with *Government Auditing Standards*.

TRANSPORTATION CABINET OF THE COMMONWEALTH OF KENTUCKY
SCHEDULE OF PRIOR AUDIT FINDINGS AND THEIR RESOLUTION
Year Ended June 30, 2002

No findings required to be reported in accordance with *Government Auditing Standards* were reported for the year ended June 30, 2001.

